Rickerby Wealth Management

A Memo from the Trenches

November 2023

TD Wealth

Memo from the Trenches

"There are decades where nothing happens … and then there are weeks when decades happen"

– Vladimir Ilyich Lenin.

I saw this quote recently and though I do not know if there was a singular catalyst that had me reflecting on this observation, but it appears to me, that given the current state of the world - by about every definition - to be enduring…. "… weeks when decades happen".

And not in a good way.

Markets

Another period of "good news is bad news" from the economic front in the US economy. Yes, inflation has very slightly declined, but GDP growth for Q3 in the US was shockingly strong and as I have mentioned previously, a little "light recession" would allow us to get through this period and onto the next business cycle. And these economic numbers underline that these interest rate conditions may be higher for longer. Indeed, as of today, Oct 23rd, the 10-year rate on a 5-year US bond crossed above 5%, the highest in about 17 years. As of the end of October, the TSX and the Dow Jones Industrial Average are down a percent or two for the year, whilst the S&P 500 is modestly up … as that index rides the coattails of seven large US tech companies. Although that trend has recently reversed as well with tech companies selling off the last 3 months quite materially.

That said, it seems possible that Canada, in the third quarter might technically be in a "recession" state and there is growing evidence and confidence from other observers that interest rates may well have peaked in Canada. Indeed, a recent presentation from our research team was suggesting that after thirty years of "globalization" there is an increasing acceptance that those trends are reversing. There was the reality that for a number of years, all the world economies were starting to align in their ups and downs, for better or worse. Now we are witnessing an increasing departure among the performance of the various world economic trading blocks. The potential positive to these changing trends though is that the benefits of diversification might become more pronounced. Perhaps when Canada is weak, the US is strong. China is going into recession …. but Japan is on its way to better growth. We shall have to see.

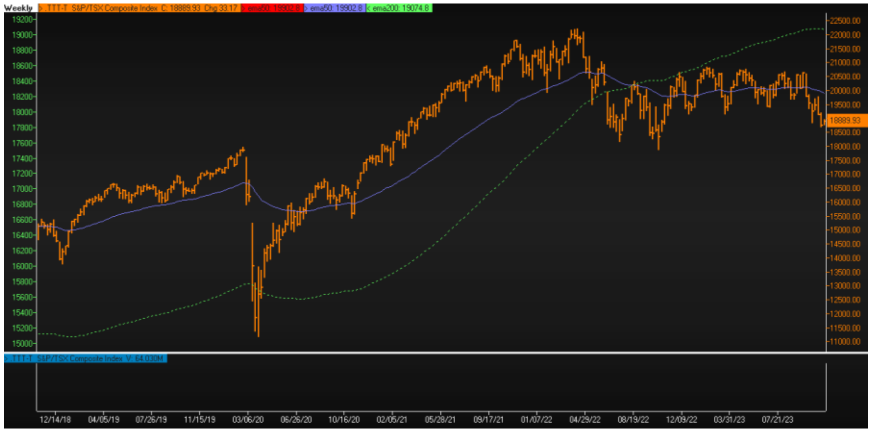
In the US model we added a little to Coke and 3M. Today, Oct 26th, both IBM and Merck posted some stronger than expected quarterly results and moved up nicely as a result. Indeed, Merck is close to a sell target and the potential buy candidate will be Home Depot now.

I was just reviewing the performance for the TD CDN Core Equity portfolio that is provided by one of our internal research teams that I have been cloning for many clients. The returns I am quoting here are BEFORE fees, but results remain quite good as of Sept 30th, 2023. Exposure to energy and materials proving the lift in recent months. (This is the 30-stock model that we have for larger client portfolios.). I have attached the Sept 30th report.

1Year	3 Year	5 Year	10 Year
8.6%	14.6%	7.8%	9.2%

A chart for perspective

Below I have printed a chart of the S&P/TSX Composite index over the last 5 years and this chart is as of Oct 31st, 2023. The peak was March of 2022 at about 22,000 and the trough was from October 2022 at about 18,000 points. We are currently about 19,000 points. It has been a grind the last 18 – 21 months with rising interest rates being the relentless headwind. And of course, you can also see the 2020 Covid "event".



Preferred Shares

Talking about preferred shares wants to pick at a wound. It is painful and I do not want to be reminded of it. BUT, there was a nice surprise recently amongst the misery at the end of October. TD Bank elected to redeem a preferred share that was widely held by clients recently. This preferred share was paying 4.75% which meant I had this large injection of cash to reinvest for clients in a world were 6% to 8% returns are readily available. TD has another preferred share that MIGHT be redeemed in 6 months, but it is nice to know that these preferred shares can and do get redeemed at $25 from time to time. All hope is not lost folks.

That said, preferred shares have struggled in this rising rate environment, and potential tax changes with regard to the Canadian banks and the tax treatment of dividend income is a possible negative. However, this proposal has not yet been decided. For preferred shares to show some strength we want to see investor sentiment improve, interest rates to stabilize and indeed perhaps have a time where investors expect the potential for a slight decrease in government bond interest rates and then preferred shares will become a place where the buyers show up again.

Despite all the volatility… For most clients we continue to receive 5 – 6%, tax favored, dividend income based on our original investment. I might point out though that at today's market valuations, the yields are extremely generous in my view.

As an example, BMO.PR.E just reset the dividend this month at $1.70 cents a share for the next 5 years and with a share trading at $22.50, that equates to a current yield of 7.5%. And do not forget, if the time comes that BMO finds it wants to redeem these shares, they must do so at $25.00.

Chief Investment Strategist TD Securities update Oct 23, 2023

I was recently on a quarterly call with John Aitkens who is our TD Securities Investment Strategist, and he was foreshadowing a slow and grinding period for equities for another year or two. However, he is of the view that government bond interest rates are close to the peak and represent a reasonable place to invest through the next 1 to 3 years. He feels that there will be a slowdown in the economy and for the moment he is giving himself until the second half of 2024 for that slow down to be called a recession. Indeed, he is recommending 45% be invested in bonds which he stated is the highest recommendation to government bonds he has had in 15 years.

Now I have yet to make a material commitment to government bonds for clients. I have been "hiding" in cash and money market investments and short term (say less than 3 years) high quality corporate bond alternatives where we are able to get 5.0% – 6% returns.

When it comes to equities, he suggests he prefers "low multiple" stocks generally and utility stocks specifically. He is quite negative on "growth" stocks. Bottom line, not an overtly negative forecast per se, but more of the same with little reason for optimism for a dramatic recovery although returns might be expected to be better than the last 2 years. He made the observation that in the last 20 years as investors, we have been familiar with dramatic… but short … periods of market decline followed by quick recoveries. Not this time though. The central bankers are not driving interest down artificially to support markets. Indeed, the opposite.

(Ed note: What is the answer to that investment thesis? As I always say… Income, Income, income.)

Fund Focus

You have seen me mention in the past that Shamus and I are keen on the energy sector. We are quite overweight in our TFSA High Growth model with 32% commitment to energy. We do this using two tools.

The BMO Equal Weight Oil and Gas ETF – ZEO - is a fund invested equally in ten of the largest energy related firms in Canada. About 10% of the TFSA High Growth Model is in this ETF. Twenty percent is invested in the Ninepoint Energy Fund and the managers mandate is going to be focused on the small and mid-cap energy companies. Both alternatives have been great contributors to portfolios in recent years but can be volatile in results from year to year.

Here are links to details on both funds. I still very much favor the energy story, but I should point out that both alternatives are "high risk".

BMO

https://www.bmogam.com/ca-en/products/exchange-traded-fund/bmo-equal-weight-oil-gas-index-etf-zeo/

Ninepoint

https://www.bmogam.com/ca-en/products/exchange-traded-fund/bmo-equal-weight-oil-gas-index-etf-zeo/

So, with that said, as we move through November and closer to Christmas, Shamus and I will be reviewing all accounts to ensure we are minimizing tax bills. Usually at this time we check for tax loss selling. which is to say, potentially tax capital losses against any capital gains, but given stock market indexes are still 10 – 15% lower than they were Jan 2022… lest be honest… not much in the way of gains to be found.

However, if you have realized capital gains in other areas … perhaps you sold some investment property … this would be the time to let us know and see if we can make some trades in portfolios to avoid paying taxes sooner than you might need to.

Until next month.

Shaun Rickerby, CFP®, CIM®, FCSI®, CIWM
Senior Portfolio Manager and Senior Investment Advisor
T: 604-482-5188
shaun.rickerby@td.com
https://advisors.td.com/rickerbywealthgroup/

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